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ORIGINAL

February 10, 1997

Mr. William F. Caton, Acting Secretary
Federal Communications Commission
1919 M Street, NW Room 222
Washington, DC 20554

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FEDERAL COMMUNICATIONS COMMISSION
OFFICE OF SECRETARY

Re: Ex Parte Presentation in CC Docket No. 97-1

Dear Mr. Caton:

Please file the attached document as part of the record in the above captioned proceeding as requested by Tom Koutsy in the Competition Division of the Office Of General Counsel.

Two copies of this Notice are being submitted to the Secretary of the FCC in accordance with Section 1.1206(a)(1) of the Commission's rules.

Sincerely,

Kimberly M. Kirby

Attachment

cc: Tom Koutsy

True Competition in the Long-Distance Market

MCI Communications Corp.
January 27, 1997

True Competition in the Long-Distance Market

Introduction: Vigorous Competition -- Lower Prices

The long-distance industry in America is extremely competitive. In fact, competition in long-distance has brought benefits to consumers -- lower prices, greater choices, and higher service quality -- that can only result from a competitive marketplace. Since 1984, the average price of a long-distance call has declined more than 70 percent. Today, nearly every call is carried over an advanced fiber optic network, and MCI alone has introduced a multitude of new communications products and services.

Indeed, the history of MCI is the history of competition in long-distance. MCI is the company that first brought competition to the long-distance market by successfully challenging AT&T's monopoly over the communication system, and built a thriving, \$18 billion company by successfully competing for every customer it has ever had -- in a competitive long-distance marketplace. No other major communications company has won every one of its customers.

This paper provides an overview of the state of competition in the long-distance market, and the detrimental impact on competition in long-distance that would occur if the Regional Bell Operating Companies (RBOCs) were to be allowed into in-region long-distance *before access charges are brought to cost*.¹

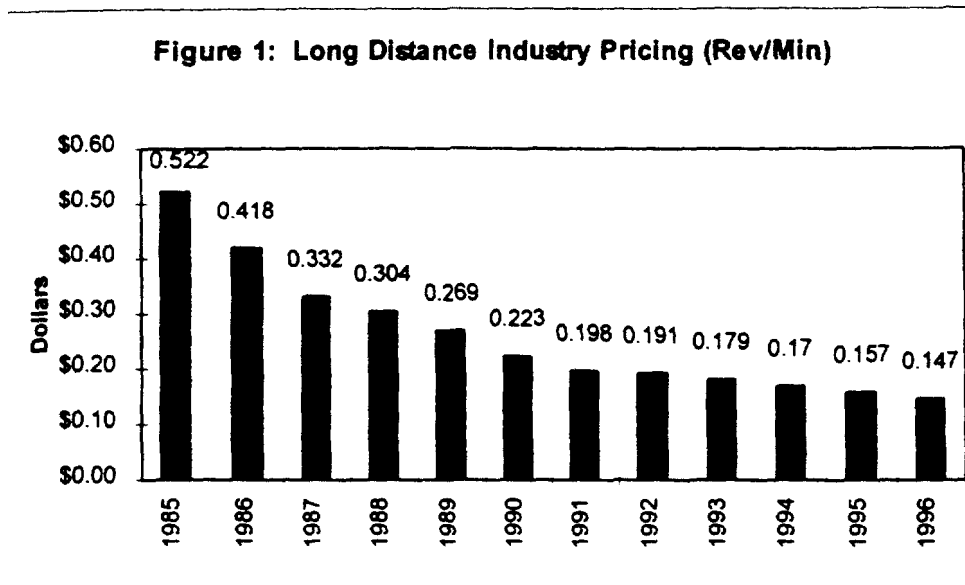
Section I describes the current state of the long-distance market, and the benefits competition has brought to consumers, including dramatic savings and choices. This was not always the case. As recently as 1984, AT&T controlled nearly 90 percent of the long-distance market, and had overwhelming advantages over its competitors. Competition was almost non-existent, much like in local markets today. However, thanks to forward-looking governmental action and aggressive rivalry among long-distance carriers, AT&T's market share today is closer to 50 percent, and its ability to dominate the market has been eliminated. Meanwhile, prices have declined 72 percent while calling volume has soared. Competition has taken the place of monopoly control.

Sections II and III describe current challenges to competition in long-distance, including premature entry by the RBOCs. At present, local monopolies collect unjustified subsidies from long-distance companies for every long-distance call. Last year alone those inflated subsidies reached about \$14 billion. If those subsidies are not eliminated before the RBOCs are allowed

¹ Of course before entering in-region long-distance, RBOCs must meet all of the requirements of section 271 of the Telecommunications Act of 1996, including full implementation of the "competitive checklist" and determination that their entry would be "consistent with the public interest, convenience, and necessity."

Declining Prices

A primary indication of vigorous competition is steadily declining prices. According to recent industry statistics, since the break up of AT&T in 1984, the average price of a long-distance call has plummeted by 72 percent, from 52 cents per minute in 1985 to about 15 cents in 1996. In other words, thanks to competition in long-distance markets, a long-distance call that cost \$1 in 1984 costs less than 30 cents today.⁵ (See Figure 1, below).



*Source: "Long-distance: Public Benefits from Increased Competition," study by Robert E. Hall, Stanford University, October 1993, updated in 1995; MCI estimates for 1996.

Recent analyses by the FCC confirm that long-distance rates have declined roughly twice as fast as access charges have declined.⁶ In fact, according to the FCC, from 1992-1995, average interstate toll revenue per minute declined \$0.032 while interstate access charges only declined on \$0.013⁷. (See Figure 2, below).

⁵ "Long-distance: Public Benefits from Increased Competition," study by Robert E. Hall, Stanford University, October 1993, updated in 1995; MCI estimates for 1996.

⁶ "Telecommunications Industry Revenue; TRS Worksheet Data," FCC, December 1996. One might note that Hall's results and the FCC's results are somewhat different. This can be attributed, among other factors, to the fact that Hall's calculations include intrastate long-distance and are based on billed rather than actual minutes.

⁷ Access charges are fees paid by long-distance carriers to local monopoly telephone companies for beginning and ending long-distance calls.

These price declines have resulted in enormous benefits for consumers. For example, the cumulative savings for consumers since 1991 totals more than \$51 billion. Local phone companies claim to have reduced access charges by \$9 billion during the same period.⁹

In addition, long-distance price declines are remarkable in comparison to other industries. There are few products whose prices have consistently fallen as much as long-distance calling. For example, in real terms, the average monthly price of cable television has increased substantially, while monthly local phone bills have barely declined when adjusted for inflation. Meanwhile, long-distance rates have plummeted. (See Figure 4, below).

Figure 4: Real Price Comparisons

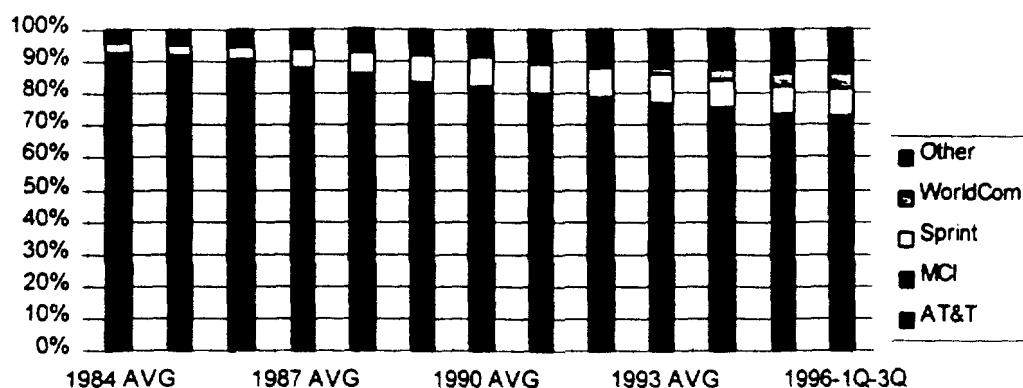
	<i>Cable TV</i> (Monthly Rate)	<i>Local Telephone</i> (Monthly Rate)	<i>Long Distance</i> (Rev/Min)
1985	\$ 14.20	\$ 21.22	\$ 0.52
1986	\$ 15.28	\$ 23.11	\$ 0.42
1987	\$ 16.83	\$ 23.02	\$ 0.33
1988	\$ 18.39	\$ 21.99	\$ 0.30
1989	\$ 19.26	\$ 22.20	\$ 0.27
1990	\$ 20.17	\$ 21.39	\$ 0.22
1991	\$ 20.86	\$ 21.51	\$ 0.20
1992	\$ 21.35	\$ 20.93	\$ 0.19
1993	\$ 21.07	\$ 20.58	\$ 0.18
1994	\$ 22.90	\$ 20.20	\$ 0.17
1995	\$ 23.13	\$ 20.13	\$ 0.16
% Change (85 to 95)	63%	-5%	-70%

*Source: The Cable TV Financial Databook, July 1995; FCC: SOCC, 1995/6 Edition; Edmunds Blue Book

While consumers have benefited from the dramatic decreases in basic long-distance rates and product discounts, this does not tell the entire story. The majority of long-distance customers in recent years have also benefited as long-distance carriers seek to acquire and retain customers through unique and valuable promotional offerings including free months of calling, airline frequent flyer bonuses, and coupons toward merchandise at national buying clubs. The result is lower prices, greater choices, and higher service quality.

⁹ "USTA Comments on FCC Access Charge NPRM," The United States Telephone Association, December 23, 1996.

Figure 6: Industry Revenue Market Share



*Source: FCC Long-distance Market Shares Third Quarter 1996, January 1997.

Competition does not just come from the major carriers, but also from resellers (including the RBOCs outside their region, GTE, SNET and others), the numerous "dial-around carriers"¹¹ such as Dial-and-Save, and pre-paid calling cards. Indeed, the number of long-distance companies has increased from a handful to over 700 -- a number that continues to grow as new resellers enter into the market daily.¹² Moreover, these smaller carriers continue to gain an increased market share. Dial-around carriers, for example, continue to increase the pressure on national providers; in two short years this industry has grown from \$0 to over \$500 million per year and continues to expand through aggressive marketing.¹³

¹¹ Dial around carriers allow customers to keep their preferred long-distance provider, while at the same time encouraging them to use their service by dialing a five digit number called a carrier identification code.

¹² "Trends in Telephone Service," Industry Analysis Division, Common Carrier Bureau, FCC, May 1996.

¹³ "Telecommunications Services," Bear Stearns, July 30, 1996, p. 3.

Competitive Markets vs. Monopoly Markets

The key difference between a competitive market and a monopoly market is that prices in a competitive market tend to move towards and with costs as consumers choose from a range of alternative service providers. In contrast, the prices of the monopolist are determined by its unconstrained profit maximizing behavior -- with only the regulator to tame its ability to convert consumer welfare into monopoly profits.

In a competitive market place, the prices for services will be driven towards their forward-looking economic costs as companies compete for customers using the best available technology.¹⁴ In telecommunications, marginal costs will vary depending on both the time and volume of network use, technology, and the cost of ancillary and promotional offerings. Given that there are fixed costs, such as billing, associated with every customer, low volume users tend to cost more on average to serve than high volume users. As a result, costs will be lower and rates may fall faster for high-volume users, and for users who make long-distance calls during off-peak hours.

Telecommunications companies, therefore, have the incentive to develop innovative rate plans that match user patterns and costs. For example, MCI pioneered the "Friends and Family" plan which provides discounts to users based, in part, on calling volume. While "Friends and Family" is a popular MCI calling plan, MCI has many different calling plans catering to the calling needs of different customers and to the cost of providing long-distance service. Today, an estimated three-quarters of MCI's customers are on one calling plan or another.

Of course, without significant barriers to entry, innovative rate plans can easily and quickly be adopted by competitors. Consumers can quickly take advantage of the opportunity to seek out innovative plans and services that best meet their needs, whether it be convenience, quality, or price. As a result, the number of customers that switch long-distance providers in any given year has steadily increased as new competitors, products and services reach the market. In 1993, nearly 20 million people switched long-distance companies. That number grew to 27 million in 1994 and 42 million in 1995. In 1996, It was estimated to exceed 50 million.¹⁵

These statistics demonstrate an important element of competitive markets: If offered a better deal, customers are willing and able to switch providers at the drop of a hat. By contrast,

¹⁴ Forward-looking cost can be contrasted with "historical" or "embedded" cost, which may reflect inefficiencies, excess investment, or the use of technology that is no longer state of the art.

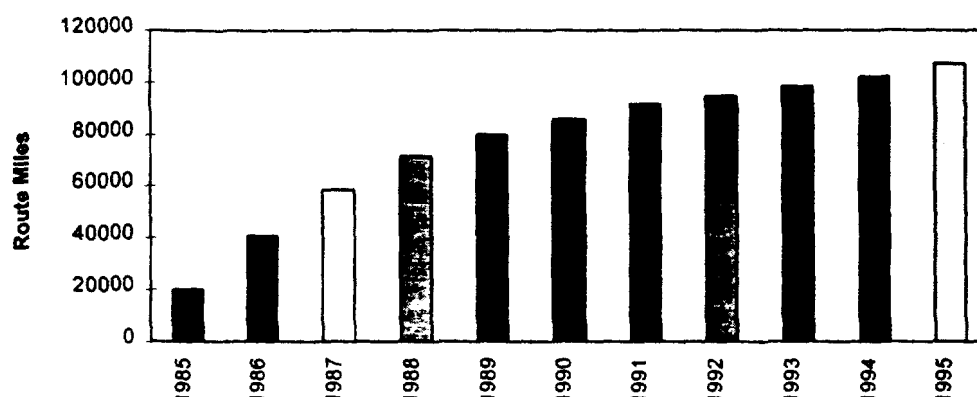
¹⁵ "Telecommunications Services," Bear Stearns, July 30, 1996, p. 2; Motion of AT&T Corp to be Reclassified as a Non-Dominant Carrier, FCC 95-427, paragraph 53, October 23, 1995; "The Long-Distance Market is Competitive," Peter K. Pitsch, September 3, 1996.

Last year fierce competition in long-distance forced overall rates down an *additional 6.2 percent*.²⁰

Investing in Technology:

Telecommunications is a high-technology business that has benefited from -- and in many respects driven -- the information technology revolution. Technological improvements and forward-looking capital investments have meant steadily increasing long-distance capacity. Since 1984, long-distance capacity has increased almost exponentially, from 20,039 route miles in 1985 to 107,589 route miles in 1995. (See Figure 9, below). At present, there are four national long-distance networks, with hundreds of firms using those networks to provide a variety of communications services, from long-distance to the Internet. In addition to the national networks, regional fiber networks are easily interlinked, creating many more seamless, ubiquitous national networks.

Figure 9: Route Miles - Interexchange Carriers



*Source: FCC: Fiber Deployment Update End of Year 1995

Security analysts, such as Solomon Brothers and Merrill Lynch, predict continued dramatic increase in long-distance capacity as WorldCom, Frontier, and Teleport complete their announced plans to build new fiber networks. Once these networks are completed, there will be six national long-distance networks in operation. To meet these competitive challenges, MCI recently announced plans to quadruple transmission speeds, and thus increase the capacity, on its fiber network.²¹

²⁰ MCI estimate of 1996 rate change for long-distance industry.

²¹ "The World's Fastest Network Gets Even Faster," MCI press release, January 6, 1997.

Despite their high margins, local companies have not invested in their networks in the same way that competitive long-distance providers have nor have they passed along the associated cost saving to consumers. Instead, they have invested in communications companies overseas or used the cost savings to pay dividends to shareholders. In fact, according to a September 1996 report by the Consumer Federation of America, "Excess Profits and the Impact of Competition on the Baby Bells," local monopolies have dramatically slowed their investment in local facilities in recent years. The report found that:

- "Per-line investment in the local network has decreased 20 percent, meaning that [RBOC] excess profits have not been used to improve service."
- "[L]ocal monopoly phone companies have enjoyed the best of both regulated and competitive worlds -- by taking guaranteed profits of their monopoly base and leveraging that cash flow to build up unregulated businesses. Working in conjunction with their parent companies, the Bells have taken money from local ratepayers and channeled it into high-risk, unregulated businesses such as video, credit cards, interactive television and even railroads."
- "[S]ince 1985, the peak year of capital expenditure for the RBOCs, capital expenditure has declined three-quarters of a billion dollars, while cash flow has increased by over \$5 billion."
- "In the last several years, capital expenditure has been approximately equal to depreciation, indicating no new net investment."

Meanwhile, over the past 12 years, MCI has continually improved its network technologies and capacity, having invested nearly \$18 billion in its intelligent network since its founding. As noted above, earlier this year, MCI announced plans to quadruple transmission speeds, and thus increase the capacity, on its fiber network.²³

While the long-distance market is competitive today, its future is not guaranteed. Sections II and III describe how current challenges to competition in long-distance, including premature entry by the Regional Bell Operating Companies (RBOCs), could put long-distance -- and local -- competition at risk. Meanwhile, the elimination of excess subsidies to the RBOCs could save consumers billions of dollars, and make the entire telecommunications market more competitive, saving consumers even more money.

²³ "The World's Fastest Network Gets Even Faster," MCI press release, January 6, 1997.

collected from all telecommunications carriers, placed in an independent fund beyond the control of local telephone monopolies, and no longer simply be hidden in access charges.²⁸ The FCC, as part of its access reform efforts, must eliminate all of the universal service subsidies that are currently contained in access charges. The FCC must ratchet down access charges to cost to provide consumers the benefits of lower long-distance prices and competition in local phone markets.

Under the competitive framework of the Telecommunications Act of 1996 and the rules for implementation set down so far, there is no economic or policy justification for continuing above-cost access charges. Access charges should come down to economic cost. When RBOC overcharges for access are abolished, MCI will pass along the savings to our customers. Historically, as recently noted by the FCC, long-distance rates have come down about twice as much as access charges.

Since 1984, consumers have seen their long-distance rates drop by an astounding 72 percent.²⁹ Just during the past five years, when the local telephone monopolies claim that access charges have declined by about \$9 billion,³⁰ actual savings passed on during the same period to consumers by competitive long-distance companies have been about \$51 billion. Even in 1996, when there were essentially no interstate access charge reductions, long-distance customers still saw the rates they pay go down. (See, also, Figure 1).

The ability of consumers to choose from among hundreds of long-distance carriers ensures that access charge savings will be passed along to long-distance customers. If MCI passes on the savings and other companies do not, the other companies will lose customers. In a market as competitive as long-distance, this will not happen.

The FCC's attempt to eliminate unjustified access charge subsidies to local providers is an important step toward bringing to local markets the same kind of vigorous competition that exists in long-distance markets today. Moreover, as the next section demonstrates, there are also serious anti-competitive consequences associated with the failure to reform access. The competitiveness of the long-distance industry could be put at risk, and the monopoly nature of local markets would be prolonged. The \$14 billion in bloated access charges provides a war chest that incumbent local monopolies can use to compete unfairly and to subsidize their entry

²⁸ Telecommunications Act of 1996, Public Law 104-104, Section 254, February 8, 1996.

²⁹ "Long-distance: Public Benefits from Increased Competition," study by Robert E. Hall, Stanford University, October 1993.

³⁰ "USTA Comments on FCC Access Charge NPRM," The United States Telephone Association, December 23, 1996.

from doing so even after they gain permission to offer long-distance service.³³ This would mean that they would be the only carrier that could provide one-stop-shopping for local and long-distance service in their region.

Each of the RBOCs would have an unfair advantage in entering the long-distance market precisely because of the competitive choice that exists for long-distance but not local service. The RBOCs may begin entry into in-region long-distance as resellers. When that is the case, the RBOCs have been able to obtain significant discounts by purchasing capacity in bulk and having the different long-distance carriers compete against one another to provide them with the lowest possible price, gaining the value of efficiencies compelled by a competitive market. These competitive market generated discounts will not be available as long-distance carriers try to enter the local market to become local service providers. There is only one provider, so the opportunity for local market entry through resale will be limited. A resale market supplied only by the monopoly is in no way similar to the current resale market in long-distance. A monopoly is a monopoly, whether selling a retail or wholesale product or service.³⁴

Currently, Southern New England Telephone (SNET), which is the local monopoly telephone company for most of Connecticut, and GTE, which operates in several states, are offering long-distance services in-region. Several of the RBOCs, including Nynex, are reselling long-distance services outside their home region. The experiences of these companies in the marketplace offer an even clearer glimpse as to why RBOC entry into in-region long-distance does not make the market more competitive.

SNET and GTE show the importance of the ability to provide one-stop-shopping. Both of these companies have had some success at winning long-distance customers. However, it appears that they are winning customers not as a result of price savings. Rather, both SNET and GTE are winning customers who want the convenience of one-stop-shopping.³⁵ Unfortunately, this is a convenience that MCI and the other long-distance companies cannot provide consumers because the local monopoly companies are dragging their feet in providing interconnection, unbundled elements, resale services, and local number portability -- all of which are needed to be

³³ For example, loss of dial tone when changing providers, misinformation about MCI's ability to provide local service, and backlogs of unfulfilled service orders forced MCI to file a complaint against PacBell with the California Public Utilities Commission.

³⁴ One might also note that arbitration decisions have concluded with different resale discounts among states, and sometimes among carriers within a state. For example, Maryland's final arbitration decision awarded MCI a 19.8% resale rate (with DA&OS), while in Virginia MCI was awarded a 21.3% resale rate (also with DA&OS). In addition, Pennsylvania's final arbitration decision awarded MCI a 21.7% resale rate while AT&T was awarded a 22.9% resale rate.

³⁵ "Telecom Services - Long-distance," Merrill Lynch, November 13, 1996, p. 4.

an economically viable alternative to local phone service; long-distance companies would be able to enter monopoly local phone markets; local phone companies would enter the video marketplace. Competition would flourish everywhere. But look at what has happened:

Only two months after the passage of the Act, four of the seven RBOCs announced their intention to merge -- Bell Atlantic with Nynex and Pacific Telesis with SBC Communications. These mergers would eliminate two potential competitors, both of which could otherwise be new entrants into the local markets now being served on a monopoly basis by their proposed partners. The mergers would substantially consolidate and strengthen the monopolists' control over the local network, making it substantially more difficult for the promise of unfettered competition to reach local markets quickly. For example, if the proposed mergers were to take place, two mega-monopolies would control more than 45 percent of the nation's local phone lines.

Meanwhile, the RBOCs' plans to enter the video and data markets are being placed on the back burner and in some instances disappearing altogether, even in the face of rising cable rates. For example, in December 1996, Nynex, Bell Atlantic, and PacTel announced that they would be significantly revising TeleTV, their "wireless cable" partnership.³⁷ Nynex and Bell Atlantic pulled out of their two wireless cable trials, (Boston, MA and Hampton Roads, VA) and closed their operations after unsuccessful trials were continually delayed because of technical problems. Nynex and Bell Atlantic froze their investment in CAI Wireless, a wireless data provider who had been chosen to provide programming to TeleTV, because of technical problems, and problems associated with cable overbuilds.³⁸

Similar technical problems continue to delay entry by the RBOCs in the video and data delivery business using their existing wireline network. Many RBOCs, for example, are finding that the costs for completing the trials and resolving the numerous technical difficulties delivering video over the existing wireline network have greatly diminished the economic viability of video.³⁹ As a result, the RBOCs have significantly scaled back their video options. The FCC, in its third annual report on the status of competition in the video marketplace, agreed with this assessment: "A large, nationwide competitive presence has not been realized and no single technology has been chosen . . . while LECs [local exchange carriers] might offer video

³⁷ "Pacific Telesis and 2 Other Bells Feud Over Future of TV Venture," *New York Times*, January 16, 1996, p. D1. In addition, Nynex and Bell Atlantic would like to completely dissolve this partnership, however, PacTel is insisting that it remain fully funded. Without TeleTV, PacTel will have no distribution mechanism for its wireless cable operation in Riverside, CA.

³⁸ Annual Assessment of the Status of Competition in the Market for the Delivery of Video Programming, CS Docket 96-496, paragraphs 72, 78.

³⁹ "Pacific Telesis and 2 Other Bells Feud Over Future of TV Venture," *New York Times*, January 16, 1996, p. D1.

Delays and Interim Decisions

In addition, local monopolies are doing all they can to protect their markets from true competition. One year after the passage of the Telecommunications Act, local phone monopolies continue to delay new competitors entry into local markets and exploit their artificial competitive advantage. In August, the FCC released its "Local Competition Order," which outlined how existing local networks are to be shared by the local monopolies and new entrants and the discounts the existing local exchange carriers must provide so new entrants can resell local services to their own customers.

Immediately following the release of the FCC's order, several of the RBOCs, GTE, SNET and others petitioned the US Court of Appeals for the 8th Circuit for an emergency stay in the implementation of the FCC order. The Court stayed several key provisions of the order, including the pricing provisions, necessary to promote certainty and investment by preventing a patchwork of inconsistent and conflicting interpretations of section 251 of the Act. Oral argument took place in January 1997, with the Court's ruling expected later this Spring.

Perhaps most concerning, however, is the pace of regulatory actions needed to break open local monopoly markets. To accelerate local competition, the Telecommunications Act requires incumbent local monopolies and new entrants to negotiate in each state the terms and conditions necessary to open the local market to true competition. Failing to agree, either party can request arbitration by the state to resolve these issues. The results of these arbitrations are having a significant impact on the pace of local competition.

Although many of these arbitrations have been concluded, the state utilities commissions have frequently rendered decisions with interim rates. This is important because failure to establish permanent rates presents new entrants with significant financial risk and uncertainty. Moreover, many states have failed to deaverage rates, masking the true costs of individual components of the local network, and, as such, hindering legitimate strategies of competitive entry.

In addition, as the RBOCs seek to provide in-region, long-distance service, they will look to these arbitrations and resulting interconnection agreements as evidence that they have satisfied the "competitive checklist." However, interim rates not based on a full analysis of "cost" for unbundled network elements and "avoided costs" in the case of resale, mean that the RBOCs cannot satisfy the requirements of the "competitive checklist."

Another significant issue is the continued assignment by local monopolies of "non-recurring charges." Many state commissions are using out-dated, or worse yet, excessive non-recurring charges for the ordering of network elements. If incumbent monopolies are allowed to continue to excessive non-recurring charges, new entrants will continue to be prevented from making efficient local market entry and purchasing decisions.

competitors' access codes and equal access information, clearly denying customers important information.

There are numerous other instances of small, but significant anti-competitive behavior and delay tactics that are slowing down new entrants' ability to enter local markets. US WEST, for example, has attempted to charge a \$5 fee for changing customers' long-distance companies, even though other local telephone companies charge as little as \$1.49 for the same procedure. In Michigan, Ameritech has continued to refuse to implement a Michigan Public Service Commission order requiring it to provide statewide intraLATA equal access. Meanwhile, in Texas, GTE continues to ignore a statutory requirement that it offer intraLATA equal access, although it is able to offer in-region long-distance.

Conclusion:

Despite these delays, MCI stands ready to enter and function as a full-fledged competitor in the provision of local service. MCI is strengthening itself in a number of key areas. Most importantly, it has a plan to bring competition to local markets the same way it brought competition to the long-distance industry.

Investing In Local Markets

Building on its record as the company that pioneered competition in long-distance, MCI is positioning itself to challenge the local monopolies' dominance of the local phone network. MCI's goal is to bring to local phone markets the same benefits of competition -- lower prices, more choices, and higher service quality -- that it has brought to the long-distance market.

Already MCI is chipping away at the Bell monopolies stranglehold, offering customers a true alternative to the local monopoly provider. To date MCI has invested nearly \$1 billion to install local phone switches. By March of 1997, MCI will be offering local service in 25 markets in 20 states. If the regulatory climate is right, MCI has plans in place to invest an additional \$700 million by the end of the year, providing service to both business and residential customers in over 30 markets in 23 states. (See figure, below)

reduction of more than 70 percent. Now, MCI has a plan to bring the same benefits -- lower prices, greater choices, innovative products and services, and greater service quality -- to local phone markets. MCI is, after all, the company that brought true competition to the long-distance industry and built a thriving, \$18 billion company by competing for every customer it has ever had.

MCI is ready to compete in virtually every telecommunications market. The pathway to success, however, will depend not only on agile and aggressive competitors. It will also depend greatly on forward-looking government actions that eliminate out-dated and unjustified subsidies and ensure through vigilant oversight that today's local monopolies not able to distort competition through anti-competitive behavior.

America deserves to realize in local markets the benefits of competition. As the experience of the long-distance industry illustrates, consumers are the real winners when monopolies are forced to compete on equal footing with new competitors.